



Government Contracts Advisory

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FAR Council Issues Final Contractor Ethics Rule Requiring Mandatory Disclosure Of Crimes And Civil False Claims Act Violations

Today, Wednesday, November 12, 2008, the FAR Council issued in the Federal Register the long-anticipated final rule that will, among other things, impose a mandatory requirement on government contractors to disclose to the relevant agency's Office of Inspector General ("OIG") whenever they have "credible evidence" of: (1) certain criminal violations; and (2) civil False Claims Act violations. The new rule will go into effect December 12, 2008, and also provides that failure to disclose these violations--as well as failure to disclose "significant overpayments" by the Government--will constitute grounds for suspension and/or debarment. Finally, the new rule imposes new business ethics awareness, compliance program, and internal control system requirements for other than small businesses and commercial-item-only contractors.

I. NEW MANDATORY DISCLOSURE REQUIREMENT

The new mandatory disclosure requirement is set forth in an amendment to the existing Contractor Code of Business Ethics and Conduct clause located at FAR 52.203-13. Under FAR 3.1004, this clause must be included in all contracts that are expected to exceed \$5 million and have a performance period of 120 days or more. The new rule, in pertinent part, provides:

The Contractor shall timely disclose, in writing, to the agency [OIG], with a copy to the Contracting Officer, whenever, in connection with the award, performance, or closeout of this contract or any subcontract thereunder, the Contractor has credible evidence that a principal, employee, agent, or subcontractor of the Contractor has committed--(A) A violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or (B) A violation of the civil False Claims Act (31 U.S.C. 3729-3733). FAR 52.203-13(b)(3)(i) (as amended by final rule).

The rule mandates flowdown of the provision to subcontracts which meet the same size and duration thresholds, but provides that subcontractor disclosures must be made directly to the government, instead of to the prime contractor.

The "Supplementary Information" accompanying the final rule gives additional insight into some of the terms used in the new mandatory disclosure requirement. First, the FAR Council states that the term "credible evidence" is intended to indicate a "higher standard" than the formerly-proposed "reasonable grounds to believe" standard. Moreover, not requiring a contractor to make a disclosure until it has credible evidence "impl[ies] that the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government." This obligation to disclose, again according to the Supplementary Information accompanying the new rule, applies to contracts that include the new clause and extends until three years after contract completion, "using final payment as the event to mark contract completion."

II. NEW GROUNDS FOR SUSPENSION AND/OR DEBARMENT

Even when a contractor is not subject to the new mandatory disclosure requirement set forth in FAR 52.203-13, the contractor nevertheless can be suspended and/or debarred for a:

Knowing failure by a principal, until 3 years after final payment on any Government contract

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awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence of--(A) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; (B) Violation of the civil False Claims Act (31 U.S.C. 3729-3733); or (C) Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.

FAR 9.406-2(b)(1)(vi), 9.407-2(a)(8) (both as amended by final rule). Unlike the disclosure obligation discussed above, according to the FAR Council's Supplementary Information, this provision applies to all government contractors upon the effective date of the new rule, without regard to whether their contracts (even ongoing ones that pre-date the effective date of the rule) contain the revised version of FAR 52.203-13.

The final rule defines a "principal" as "an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a subsidiary, division, or business segment; and similar positions." FAR 2.101(b)(2) (as amended by final rule). The Supplementary Information for the final rule notes that the FAR Council intends for this definition to be "interpreted broadly, and could include compliance officers or directors of internal audit, as well as other positions of responsibility." Although the new rule defines "principal," the new rule does not define what it means for a failure to disclose to be "knowing" or what is a "significant overpayment."

III. NEW INTERNAL CONTROL SYSTEM REQUIREMENTS

The newly-amended clause at FAR 52.203-13 also requires contractors (other than small businesses and contractors who only have commercial-item contracts) to establish: (1) business ethics awareness and compliance programs; and (2) internal control programs. A contractor's business ethics awareness and compliance program must include "effective training programs" and the dissemination of information "appropriate to an individuals' respective roles and responsibilities." FAR 52.203-13(c)(1)(i) (as amended by final rule). The training provided must be given to the "Contractor's principals and employees, and as appropriate, the Contractor's agents and subcontractors." FAR 52.203-13(c)(1)(ii) (as amended by final rule).

The internal control system required by the final rule is more robust than that formerly required by the FAR. The requirements of the internal control system are based on the United States Sentencing Guidelines. The new requirements include, but are not limited to: (1) "[t]imely disclosure, in writing, to the agency OIG, with a copy to the Contracting Officer, whenever, in connection with the award, performance, or closeout of any Government contract performed by the Contractor or any subcontract thereunder, the Contractor has credible evidence that a principal, employee, agent, or subcontractor of the Contractor has committed a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code or a violation of the civil False Claims Act (31 U.S.C. 3729-3733);" (2) "[r]easonable efforts not to include an individual as a principal, whom due diligence would have exposed as having engaged in conduct that is in conflict with the Contractor's code of business ethics and conduct;" and (3) "[f]ull cooperation with any Government agencies responsible for audits, investigations, or corrective action." FAR 52.203-13(c)(2)(ii) (as amended by final rule).

According to the final rule's Supplementary Information, the requirement to make timely disclosures of criminal violations and civil False Claims Act violations also applies to contractors whose contracts do not include the revised FAR 52.203-13 and its new internal control system requirements. And, again, this includes ongoing contracts. With respect to the "full cooperation" requirement, the new rule states that full cooperation "does not require--(i) [a] Contractor to waive its attorney-client privilege or the protections afforded by the attorney work product doctrine; or (ii) [a]ny officer, director, owner, or employee of the Contractor, including a sole proprietor, to waive his or her attorney client privilege or Fifth Amendment rights." FAR 52.203-1(a) (as amended by final rule). Full cooperation also "[d]oes not restrict a Contractor from--(i) [c]onducting an internal investigation; or (ii) [d]efending a proceeding or dispute arising under the contract or related to a potential or disclosed violation." *Id.*

IMPLICATIONS

The implications and consequences of this new rule are both far reaching and far from clear. Experience with existing mandatory disclosure requirements in certain agency contracts has been varied and suggests a number of issues left open by the regulation will need to be resolved on a case by case basis with the IG agents who will pursue alleged violations of the new rule. It is clear that, despite extensive

comments and revisions, this final rule imposes significant new compliance obligations on contractors and makes it even more important for contractors to be ever-vigilant in ensuring that they promptly, carefully and thoroughly review all reports or indications of potentially applicable misconduct. Non-disclosure decisions will need to be carefully documented, even if it is only to document that the reported conduct was of no potential significance. Once disclosures are made, as under the 'voluntary disclosure' program, contractors will have to consider whether to continue to investigate, document and report, in an effort to permit the IG to conduct a 'verification' investigation, instead of a prosecution. As before, contractors will need to consider, at the time of the disclosure, their position with respect to possible suspension and debarment issues. Agreements with subcontractors, agents and employees will need to be revised to accommodate the new requirements. Contractors also must ensure that when they are reporting civil False Claims Act violations, as discussed herein, they consider carefully how to protect themselves from parasitic relators who will point to judicial determinations that disclosure to the government does not constitute public disclosure.

For full text of the new FAR Case Regulations, please [click here](#).

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